No. 06-659

In the Supreme Court of the United States

COLTEC INDUSTRIES, INC., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the court of appeals applied the correct standard of review in determining that petitioner's underlying transaction lacked economic substance (and that petitioner was therefore not entitled to claim a capital-loss tax deduction related to that transaction).

2. Whether the court of appeals applied the correct substantive standard in determining that petitioner's transaction lacked economic substance.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-33a) is reported at 454 F.3d 1340. The opinion of the Court of Federal Claims (Pet. App. 34a-123a) is reported at 62 Fed. Cl. 716.

JURISDICTION

The judgment of the court of appeals was entered on July 12, 2006. A petition for rehearing was denied on September 19, 2006 (Pet. App. 124a). The petition for a writ of certiorari was filed on November 8, 2006. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. a. In 1996, petitioner, a diversified manufacturing company, decided to sell one of its subsidiaries. Peti-

tioner expected to generate a taxable capital gain of over $240 million from the sale. In an effort to reduce or eliminate its tax liability resulting from that gain, petitioner contacted its tax adviser, the now-defunct accounting firm Arthur Andersen. To that end, Arthur Andersen proposed that petitioner use a tax-planning scheme that it had been marketing to other corporate clients with sizable contingent liabilities. Petitioner had such contingent liabilities because one of its subsidiaries, Garlock (and its subsidiary, Anchor Packing Company), had previously manufactured and distributed asbestos products. Pet. App. 2a-3a; C.A. App. 703, 2282, 2540-2546, 7200-7201.

Although Arthur Andersen's tax-planning scheme was complex, the ultimate goal was simple: namely, to allow the taxpayer to circumvent the prohibition on immediate deductions for contingent liabilities by converting those liabilities into an artificial capital loss. The tax-planning scheme involved three steps. First, the parent company would reorganize a dormant subsidiary corporation into a special-purpose entity. Second, the parent company would transfer property and contingent liabilities to the newly reorganized subsidiary in exchange for stock. Third, the parent company would sell the stock to a third party for its (nominal) fair market value. For tax purposes, the parent company would use the value of the transferred property as the tax basis for the sale, without taking into account the amount of the contingent liabilities, under the basis rules applicable to intracorporate tax-free transfers. As a result, the parent company would accrue a significant capital loss from the sale of the stock, because the tax basis for the sale would be considerably higher than the amount received. The resulting capital loss could then be used to offset

any capital gain realized by the taxpayer during the relevant tax year. Pet. App. 2a-3a, 5a.

Petitioner decided to implement Arthur Andersen's tax-planning scheme. First, petitioner selected a dormant subsidiary corporation, renamed it Garrison Litigation Management Group, and reorganized it into a special-purpose entity. Second, petitioner transferred property to Garrison in exchange for stock and Garrison's agreement to pay Garlock's contingent liabilities. Specifically, petitioner caused one of Garlock's other subsidiaries, Stemco, to issue a $375 million promissory note to Garlock, and then caused Garlock to issue an offsetting $314 million promissory note in return to Stemco. Petitioner then transferred the $375 million promissory note from Garlock to Garrison, in return for Garrison's assuming Garlock's asbestos-related liabilities (which had been estimated for purposes of the tax shelter, using generous assumptions, at $375 million). Garrison issued 100,000 shares of common stock to Garlock—the shares that would ultimately give rise to Coltec's claimed capital loss. (Garrison also issued a controlling block of shares to petitioner.) Third, Garlock sold the 100,000 shares of Garrison stock to two banks, in return for $500,000. As part of that sale, petitioner agreed to indemnify the banks against any asbestos-related claims. Pet. App. 3a-5a & n.2, 53a, 57a.

On its income tax return for 1996, petitioner claimed that Garlock's basis in the Garrison stock was $379.2 million (representing the $375 million Stemco note and $4.2 million in other property contributed by Garlock to Garrison). Petitioner did not reduce this basis by the $375 million in contingent liabilities assumed by Garrison. Because Garlock sold the stock for only $500,000, it claimed a capital loss on the transaction of $378.7 mil-

lion. That loss more than offset petitioner's gains for that tax year; in fact, petitioner carried over the unused portion of the loss to offset gains in future years. Petitioner recognized that loss only for tax purposes; the loss was not reported on petitioner's public financial statements, although a loss of that size would plainly have been material. Pet. App. 5a.

2. The Internal Revenue Service (IRS) disallowed the claimed loss and assessed tax deficiencies totaling more than $82 million. Pet. App. 6a. The loss was disallowed on two grounds. First, the IRS determined that petitioner had erroneously excluded the amount of the contingent liabilities from the basis for the stock under the statutory provisions governing the calculation of basis in intracorporate tax-free transfers. See 26 U.S.C. 358.[1] Second, and more relevant here, the IRS determined that, even if petitioner had correctly calculated the basis for the stock under those provisions, petitioner was not entitled to claim a loss under the economic-substance doctrine. That doctrine provides that a claimed tax deduction may be disallowed if the underlying transaction lacks economic substance, *i.e.*, if "there was nothing of substance to be realized by [the taxpayer] from th[e] transaction beyond a tax deduction." *Knetsch* v. *United States*, 364 U.S. 361, 366 (1960); see *Gregory* v. *Helvering*, 293 U.S. 465, 469-470 (1935).

3. After paying the assessed amount, petitioner filed a refund suit in the Court of Federal Claims. After a bench trial, the court entered judgment in favor of petitioner. Pet. App. 34a-123a. With regard to the government's statutory arguments, the court first held that the

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[1] Unless otherwise noted, all references in this brief to the relevant statutory provisions are to the 1994 edition of the United States Code.

contingent liabilities were subject to exclusion from petitioner's basis because they did not even constitute "liabilities" under 26 U.S.C. 358(d)(1). Pet. App. 77a-78a. In the alternative, the court held that the contingent liabilities were subject to exclusion under 26 U.S.C. 358(d)(2), because they would "give rise to a deduction" under an incorporated statutory provision, 26 U.S.C. 357(c)(3). Pet. App. 91a-93a. The court also held that the transaction did not trigger a statutory anti-abuse provision, 26 U.S.C. 357(b)(1), because "the principal purpose of [petitioner] entering into the Garrison transaction was not solely to avoid federal income tax," Pet. App. 84a-85a, and because "Garrison's assumption of Garlock's contingent asbestos liabilities had a '*bona fide*' business purpose." *Id.* at 91a.

The Court of Federal Claims also rejected the government's argument that the loss should be disallowed because the relevant underlying transaction lacked economic substance. Pet. App. 109a-119a. The court concluded that, "where a taxpayer has satisfied all statutory requirements established by Congress, * * * the use of the 'economic substance' doctrine to trump 'mere compliance with the Code' would violate the separation of powers." *Id.* at 119a. And the court added that, even assuming that the economic-substance doctrine were applicable, it would conclude that petitioner's transaction had economic substance, based on its determination that "[petitioner] satisfied the tax avoidance and business purpose tests in" the statutory anti-abuse provision, 26 U.S.C. 357(b)(1). Pet. App. 115a.

4. The court of appeals vacated and remanded. Pet. App. 1a-33a.

a. The court of appeals, like the trial court, ultimately concluded that petitioner's claimed capital loss

"falls within the literal terms of the statute." Pet. App. 17a. The court of appeals did reject the trial court's conclusion that contingent liabilities did not even constitute "liabilities" under 26 U.S.C. 358(d)(1), reasoning that "[i]t is widely recognized that when one party in an exchange assumes a contingent liability of another party, that contingent liability, like all other liabilities, forms an integral part of the purchase price in the exchange." Pet. App. 9a. But the court of appeals agreed with the trial court that the contingent liabilities were nevertheless subject to exclusion from petitioner's basis under 26 U.S.C. 358(d)(2), because they would "give rise to a deduction" under an incorporated statutory provision, 26 U.S.C. 357(c)(3). Pet. App. 12a-13a. Finally, while the court of appeals also agreed with the trial court that the transaction was not subject to the statutory anti-abuse provision, 26 U.S.C. 357(b)(1), it reached that conclusion on a different ground: namely, that, while the relevant provisions "are not a model of statutory draftsmanship," Section 357(b)(1) was inapplicable because it was not incorporated into Section 358(d)(2), the statutory provision governing exclusions from basis in intracorporate tax-free transfers. Pet. App. 14a-17a.

b. Unlike the trial court, however, the court of appeals held that the relevant underlying transaction lacked economic substance. Pet. App. 17a-33a. The court of appeals first rejected as "untenable" the trial court's holding that the economic-substance doctrine violated the separation of powers. *Id.* at 17a. The court of appeals explained that, "[o]ver the last seventy years, the economic substance doctrine has required disregarding, for tax purposes, transactions that comply with the literal terms of the tax code but lack economic reality." *Id.* at 18a. The court of appeals reasoned that, "[i]n re-

jecting the economic substance doctrine, the [trial] court failed to follow binding precedent of the Supreme Court and this court and its predecessor court, the Court of Claims." *Id.* at 17a. "Even if we were to assume that the decisions of the Supreme Court and our predecessor court recognizing the economic substance doctrine are not binding," the court of appeals continued, "we cannot agree that the doctrine is somehow unconstitutional." *Id.* at 20a. The court reasoned that "[t]he economic substance doctrine represents a judicial effort to enforce the statutory purpose of the tax code." *Id.* at 21a. "In this regard," the court added, "the economic substance doctrine is not unlike other canons of construction that are employed in circumstances where the literal terms of a statute can undermine the ultimate purpose of the statute." *Ibid.*

The court of appeals then considered, and rejected, the trial court's alternative holding that the underlying transaction had economic substance in any event. Pet. App. 23a-33a. The court of appeals explained that, "[w]hile the [economic-substance] doctrine may well also apply if the taxpayer's sole subjective motivation is tax avoidance even if the transaction has economic substance, a lack of economic substance is sufficient to disqualify the transaction without proof that the taxpayer's sole motive is tax avoidance." *Id.* at 24a (footnote omitted). The court stated that "the economic substance of a transaction must be viewed objectively rather than subjectively." *Id.* at 25a. And the court noted that, in applying the economic-substance doctrine, "the transaction to be analyzed is the one that gave rise to the alleged tax benefit," *id.* at 26a, and that "arrangements with subsidiaries that do not affect the economic interest

of independent third parties deserve particularly close scrutiny," *id.* at 27a.

Having stated those general principles, the court of appeals determined that the relevant underlying transaction lacked economic substance. Pet. App. 28a-33a. At the outset, the court noted that "[t]he ultimate conclusion as to business purpose is a legal conclusion, which we review without deference." *Id.* at 28a. At the same time, the court observed that "the underlying relevant facts are in large part undisputed." *Ibid.*

The court of appeals proceeded to determine that the trial court had erred in two respects. First, the court of appeals noted that the trial court had determined that the creation of Garrison to manage petitioner's asbestos liabilities served a *bona fide* business purpose. Pet. App. 29a. The court of appeals explained, however, that the trial court erred by focusing on the wrong transaction, because the transfer of management activities was not "the transaction that gave the taxpayer a high basis in the stock and thus gave rise to the alleged benefit upon sale." *Ibid.* Instead, the court of appeals reasoned, the relevant transaction was "Garrison's assumption of Garlock's asbestos liabilities in exchange for the $375 million note." *Ibid.* The court concluded that, as to that transaction, "[petitioner] has not demonstrated any business purpose to be served by linking Garrison's assumption of the liabilities to the centralization of litigation management." *Id.* at 29a-30a (footnote omitted).

Second, the court of appeals noted that the trial court had determined that the overall transaction was designed to strengthen petitioner's position against potential veil-piercing claims. Pet. App. 30a. While recognizing that petitioner's executives had testified about the veil-piercing benefits that they allegedly perceived from

the transaction, *id.* at 31a, the court of appeals concluded that "[the] subjective views of [petitioner's] executives, even if credited, * * * are insufficient to establish economic substance." *Ibid.* Instead, the court reasoned, "there is no basis in reality for the idea that a corporation can avoid exposure for past acts by transferring liabilities to a subsidiary." *Id.* at 32a. The court explained that "the transaction here could only affect relations among [petitioner] and its own subsidiaries—it has absolutely no effect on third party asbestos claimants." *Ibid.*

Having noted those two errors, the court of appeals stated that it "s[aw] nothing indicating that the transfer of liabilities in exchange for the note effected any real change in the 'flow of economic benefits,' provided any real 'opportunity to make a profit,' or 'appreciably affected' [petitioner's] beneficial interests aside from creating a tax advantage." Pet. App. 33a. Because "Garrison's assumption of Garlock's liabilities in exchange for the Stemco note served no purpose other than to artificially inflate Garlock's basis in its Garrison stock," the court concluded, "[t]hat transaction must be disregarded for tax purposes." *Ibid.*

5. Petitioner filed a petition for panel rehearing, which the court of appeals denied without recorded dissent. Pet. App. 124a.

ARGUMENT

Petitioner contends (Pet. 14-17) that the court of appeals erred by applying *de novo* review to the district court's ultimate determination that its transaction had economic substance, and also contends (Pet. 18-28) that the court of appeals erred by focusing solely on whether its transaction lacked economic substance as an objec-

tive matter and not on whether petitioner had a non-tax business purpose for engaging in the transaction. The court of appeals' decision is correct, and further review is not warranted on either issue.

1. As a preliminary matter, petitioner does not contend that the court of appeals' ultimate holding—*i.e.*, that petitioner's underlying transaction lacked economic substance—directly conflicts with the holding of any other court of appeals. Nor could it, because the only other court of appeals to have considered a similar tax shelter also reversed the trial court's determination that the transaction at issue had economic substance (and, in that case, remanded for further proceedings). See *Black & Decker Corp.* v. *United States*, 436 F.3d 431, 440-443 (4th Cir. 2006).

2. Instead, petitioner contends (Pet. 14-17) that the court of appeals erred by applying *de novo* review to the district court's ultimate determination that its transaction had economic substance.[2] That claim does not warrant further review.

a. In this case, after noting that "the underlying relevant facts are in large part undisputed," the court of appeals explained that a trial court's "ultimate conclusion" as to whether a transaction had economic substance is reviewed "without deference." Pet. App. 28a. That description of the applicable standard of review is correct. As this Court explained in holding that a transaction involving a sale-leaseback arrangement had economic substance, "[t]he general characterization of a transaction for tax purposes is a question of law subject to review," whereas "[t]he particular facts from which

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[2] The same question is presented in *Dow Chemical Co.* v. *United States*, petition for cert. pending, No. 06-478 (filed Oct. 4, 2006).

the characterization is to be made are not so subject." *Frank Lyon Co.* v. *United States*, 435 U.S. 561, 581 n.16 (1978).[3] That standard of review, moreover, is consistent with the standard of review applicable to similar "mixed" questions of law and fact. See, *e.g.*, *Ornelas* v. *United States*, 517 U.S. 690, 696-697 (1996) (applying *de novo* review to "ultimate determinations of reasonable suspicion and probable cause," while recognizing that clear-error review applies to the "determination of historical facts" underlying that ultimate determination); cf. *Salve Regina Coll.* v. *Russell*, 499 U.S. 225, 233

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[3] Petitioner contends (Pet. 17) that, in *Frank Lyon*, this Court distinguished between "how transactions are characterized under the tax code" and "factual findings of economic substance." However, the fairer reading of the language quoted above—and the other cases on which petitioner relies (Pet. 16)—is that the Court was distinguishing between an *ultimate* determination that a transaction has (or lacks) economic substance and *subsidiary* determinations on historical facts. Cf. *Bazley* v. *Commissioner*, 331 U.S. 737, 743 (1947) (concluding that the lower courts were operating under "no misconception of law" and that "the facts as found by the Tax Court bring them within [the applicable legal rule]"); *Commissioner* v. *Court Holding Co.*, 324 U.S. 331, 333-334 (1945) (stating that "the findings of the Tax Court * * * must * * * be accepted by the [appellate] courts" and that an appellate court was not free to "draw[] different inferences from the record"). The distinction that petitioner posits would be entirely illusory, because how a transaction is characterized under the Internal Revenue Code will often turn on whether the underlying transaction had economic substance. In *Frank Lyon*, the Court made the statement quoted above in the course of rejecting the government's contention that the taxpayer, although the nominal owner of the property purchased from and leased back to the bank, was not in substance the true owner entitled to take depreciation deductions. 435 U.S. at 581. Moreover, the Court cited as authority for its statement of the standard of review a Fourth Circuit decision that similarly involved the economic-substance doctrine. See *id.* at 581 n.16 (citing *American Realty Trust* v. *United States*, 498 F.2d 1194, 1198 (4th Cir. 1974)).

(1991) (noting that more deferential review of "mixed" questions is warranted only where "the district court is better positioned than the appellate court to decide the issue in question or * * * probing appellate scrutiny will not contribute to the clarity of legal doctrine") (internal quotation marks omitted).

As petitioner correctly notes (Pet. 14), several courts of appeals have stated that a district court's determination as to whether a transaction had economic substance was reviewable only for clear error. See, *e.g.*, *Nicole Rose Corp.* v. *Commissioner*, 320 F.3d 282, 284 (2d Cir. 2002); *ASA Investerings P'ship* v. *Commissioner*, 201 F.3d 505, 511 (D.C. Cir.), cert. denied, 531 U.S. 871 (2000); *ACM P'ship* v. *Commissioner*, 157 F.3d 231, 245 (3d Cir. 1998), cert. denied, 526 U.S. 1017 (1999); *Yosha* v. *Commissioner*, 861 F.2d 494, 499 (7th Cir. 1988); *Rice's Toyota World, Inc.* v. *Commissioner*, 752 F.2d 89, 92 (4th Cir. 1985). Those decisions, however, contain minimal analysis—and, with regard to at least some of those decisions, it is unclear whether the courts were deferring to the ultimate determination on economic substance, or merely to underlying factual determinations that may have been dispositive of that ultimate determination. Moreover, to the extent that those courts did hold that a district court's ultimate determination on economic substance was reviewable only for clear error, those decisions cannot be reconciled with this Court's statement of the applicable standard of review in *Frank Lyon*.

b. In any event, this case does not provide the Court with a suitable opportunity to revisit any question concerning the standard of review applicable to a district court's ultimate determination on economic substance, because petitioner did not preserve any argument that

such a determination should be subject to deferential review. In the court of appeals, petitioner argued, at most, that the trial court's *underlying* factual findings were reviewable only for clear error—and never suggested that the trial court's *ultimate* determination was also subject to clear-error review. See, *e.g.*, Pet. C.A. Br. 33 n.18 (generically stating that "[t]he [Court of Federal Claims'] factual determinations may be disturbed only if they were clearly erroneous"); cf. *id.* at 32 n.17 (criticizing the government for "assert[ing] that the CFC made a legal error" instead of "directly disputing the CFC's findings of fact"). Accordingly, it is unsurprising that the court of appeals, without extended discussion, stated that a trial court's "ultimate conclusion" on economic substance should be reviewed "without deference." Pet. App. 28a.[4]

This case would constitute a poor vehicle for considering the standard-of-review question now raised by petitioner for another reason. In vacating the decision of the Court of Federal Claims, the court of appeals did not overturn any of that court's factual findings, but instead held (1) that the trial court erred by focusing on the wrong transaction, see Pet. App. 28a-30a, and (2) that the trial court erred by concluding that the transaction at issue could have strengthened petitioner's position against potential veil-piercing claims, see *id.* at 30a-33a. Although petitioner contends (Pet. 23-28) that the trial court did not err in either respect, petitioner

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[4] Moreover, petitioner did not seek rehearing (either by the panel or by the en banc Federal Circuit) on the standard-of-review issue. Instead, in its petition for panel rehearing, petitioner merely challenged various facets of the court of appeals' substantive holding that the transaction lacked economic substance. See, *e.g.*, Pet. for Panel Reh'g 1-2 (listing issues presented).

does not dispute that each of those errors was legal, rather than factual, in nature. Petitioner does not explain how the clear-error standard of review could meaningfully be applied to the trial court's resolution of those subsidiary legal issues. *A fortiori*, it would have been incongruous for the court of appeals to have engaged in clear-error review of the trial court's *ultimate* determination that the transactions at issue had economic substance, when that determination rested on the trial court's (erroneous) resolution of those subsidiary legal questions. Because the court of appeals did not pass on *any* subsidiary factual issues in reversing the trial court's ultimate determination on economic substance—and indeed recognized that "the underlying relevant facts are in large part undisputed," Pet. App. 28a—this case is an exceptionally weak candidate for application of a deferential standard of review.

3. Petitioner also contends (Pet. 18-28) that the court of appeals erred by focusing solely on whether its transaction lacked economic substance as an objective matter and not on whether petitioner had a non-tax business purpose in engaging in the transaction. While the courts of appeals have articulated the substantive standard for determining whether a taxpayer's transactions had economic substance in somewhat different ways, they have applied that standard consistently, and the court of appeals in this case articulated that standard correctly. Further review is therefore not warranted at this time.

a. The court of appeals held in this case that "the economic substance of a transaction must be viewed objectively rather than subjectively," Pet. App. 25a, and added that, "[w]hile the [economic-substance] doctrine may well also apply if the taxpayer's sole subjective motivation is tax avoidance even if the transaction has eco-

nomic substance, a lack of economic substance is sufficient to disqualify the transaction without proof that the taxpayer's sole motive is tax avoidance." *Id.* at 24a (footnote omitted). That statement of the applicable standard is correct. As the court of appeals noted, this Court's cases "have repeatedly looked to the objective economic reality of the transaction in applying the economic substance doctrine." *Id.* at 25a; see, *e.g.*, *Frank Lyon*, 435 U.S. at 573 (noting that "the Court has looked to the objective economic realities of a transaction rather than to the particular form the parties employed"); *Gregory* v. *Helvering*, 293 U.S. 465, 469-470 (1935) (stating that "the question for determination is whether what was done, *apart from the tax motive*, was the thing which the statute intended," and concluding that "[t]he rule which excludes from consideration the motive of tax avoidance is not pertinent to the situation, because the transaction upon its face lies outside the plain intent of the statute") (emphasis added).

Petitioner contends (Pet. 20) that the court of appeals adopted a "disjunctive" standard and thereby held that a transaction could lack economic substance *either* if it lacked economic substance as an objective matter *or* if the taxpayer lacked a non-tax business purpose in engaging in the transaction. It is clear from the language quoted above, however, that the court of appeals did not address the question whether the economic-substance doctrine could apply solely on the basis that the taxpayer lacked a non-tax business purpose for the transaction, where the transaction had economic substance as an objective matter. Because the court of appeals left open that question, the decision below does not conflict with the decisions of other courts of appeals framing the

standard in "disjunctive" terms—and petitioner does not so contend. See Pet. 20-21.[5]

b. Petitioner seemingly suggests (Pet. 21-22) that the court of appeals' decision conflicts with the decisions of various courts of appeals applying a "unitary" standard, under which courts have considered a taxpayer's intent as "inform[ing] the analysis of whether the transaction had sufficient substance * * * to be respected for tax purposes." *ACM P'ship*, 157 F.3d at 247; see, *e.g.*, *Rose* v. *Commissioner*, 868 F.2d 851, 853 (6th Cir. 1989) (stating that "[a] taxpayer's subjective business purpose * * * may be relevant to [the economic-substance] inquiry"); *Sochin* v. *Commissioner*, 843 F.2d 351, 354 (9th Cir.) (noting that "consideration of business purpose" was "simply [a] more precise factor[] to consider in the application of this court's traditional sham analysis"), cert. denied, 488 U.S. 824 (1988). The court of appeals in this case, however, did not hold that a taxpayer's intent was *irrelevant* to the economic-substance inquiry. As petitioner at one point concedes (Pet. 18), the better reading of the court of appeals' decision is that it viewed proof that the taxpayer had a non-tax business purpose for the transaction—as a "pertinent" factor in that inquiry: *i.e.*, as probative, but not dispositive, evidence that the transaction had economic substance as an objective matter. Pet. App. 23a; cf. *id.* at 31a-32a (noting that "[the] subjective views of [petitioner's] executives [with regard to veil-piercing benefits] * * * are insufficient to establish economic substance" where "there is no basis in reality" to support

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[5] Petitioner does not identify any case in which a court of appeals has actually held that a transaction lacked economic substance *solely* on the ground that the taxpayer lacked a non-tax business purpose in engaging in the transaction.

the existence of those benefits). Moreover, as petitioner also conce (Pet. 23), even if the court of appeals' decision were d as discounting a taxpayer's intent altogether, it is at best questionable whether petitioner would prevail in this case if the existence of a non-tax business purpose were merely relevant to, but not dispositive of, the economic-substance inquiry. The court of appeals' decision therefore does not conflict with decisions applying a "unitary" standard.

c. Petitioner's primary contention (Pet. 19-20) is that the court of appeals' decision conflicts with decisions of the Fourth and District of Columbia Circuits applying a "conjunctive" standard, under which a transaction could lack economic substance only if it lacked economic substance as an objective matter *and* if the taxpayer lacked a non-tax business purpose in engaging in the transaction. Petitioner suggests (Pet. 23) that, if that standard were applied in this case, petitioner would prevail, based on the trial court's findings that "the principal purpose of [petitioner] entering into the Garrison transaction was not solely to avoid federal income tax," Pet. App. 84a-85a, and that "Garrison's assumption of Garlock's contingent asbestos liabilities had a '*bona fide*' business purpose." *Id.* at 91a.

As petitioner notes (Pet. 19), the Fourth and District of Columbia Circuits have articulated the substantive standard for determining whether a taxpayer's transactions had economic substance in "conjunctive" terms. See, *e.g.*, *Horn* v. *Commissioner*, 968 F.2d 1229, 1237 (D.C. Cir. 1992) (stating that "a transaction undertaken for a nontax business purpose will not be considered an economic sham *even if* there was no objectively reasonable possibility that the transaction would produce profits"); *Rice's Toyota World*, 752 F.2d at 91 (providing

that, "[t]o treat a transaction as a sham, the court must find that the taxpayer was motivated by no business purposes other than obtaining tax benefits * * * and that the transaction has no economic substance because no reasonable possibility of a profit exists"). The court of appeals in this case, moreover, expressly rejected the Fourth Circuit's formulation of the standard, on the ground that it was "not consistent with the Supreme Court's pronouncements in cases such as *Frank Lyon*." Pet. App. 24a n.14.

Any divergence between the court of appeals' formulation and those of the Fourth and District of Columbia Circuits, however, does not warrant further review at this time, because petitioner identifies no case in which either of those courts has actually held that a transaction had economic substance *solely* on the basis that the taxpayer had a non-tax business purpose for the transaction, even though the transaction lacked economic substance as an objective matter. See *Rice's Toyota World*, 752 F.2d at 92-95 (affirming trial court's determinations both that the transaction lacked economic substance as an objective matter and that the taxpayer had no non-tax business purpose for the transaction); cf. *Horn*, 968 F.2d at 1236, 1238 (noting trial court's determination that "the taxpayers engaged the transactions in such a way as to create the tax benefits while completely avoiding economic risk" and the parties' assumption that "no evidence has shown a nontax business purpose," but concluding that the applicable statute nevertheless expressly authorized the claimed tax benefits).

Indeed, in the wake of more recent decisions from each circuit, it is far from clear whether the "conjunctive" test articulated by those circuits differs in any meaningful way from the tests articulated by other cir-

cuits. In a case involving the same type of tax shelter at issue here, the Fourth Circuit, while reiterating its "conjunctive" formulation from *Rice's Toyota World*, explained that both prongs of its formulation were "directed to the same question: whether the transaction contained economic substance aside from the tax consequences." *Black & Decker*, 436 F.3d at 441 (citation omitted). In the same case, moreover, the Fourth Circuit made clear that "a taxpayer's mere assertion of subjective belief in the profit opportunity from a transaction[,] particularly in the face of strong objective evidence that the taxpayer would incur a loss, cannot by itself establish that the transaction was not a sham." *Id.* at 443 (internal quotation marks and citation omitted). For its part, the District of Columbia Circuit, without so much as citing its earlier formulation in *Horn*, stated in a later case that, under the economic-substance doctrine, "the absence of a nontax business purpose is fatal." *ASA Investerings P'ship*, 201 F.3d at 512. The court added that "a transaction will be disregarded if it did not *appreciably* affect [taxpayer's] beneficial interest except to reduce his tax." *Id.* at 514 (internal quotation marks and citation omitted).

As matters currently stand, therefore, it is at best uncertain whether either the Fourth Circuit or the District of Columbia Circuit would actually hold that a transaction had economic substance *solely* on the basis that the taxpayer had a non-tax business purpose for the transaction, even though the transaction lacked economic substance as an objective matter. As the court of appeals in this case suggested, such a holding would be inconsistent with this Court's decisions on the economic-substance doctrine, which have focused on whether the transaction at issue had economic substance as an objec-

tive matter. See p. 15, *supra*. And it would allow a corporation to obtain tax advantages for a transaction entirely lacking in objective economic substance simply by coming forward with testimony from its executives concerning the purported business motivations for the transaction. In the event that a court of appeals were to allow a taxpayer to avoid application of the economic-substance doctrine on that basis, a genuine conflict would then exist, and further review might be warranted. At this time, however, there is no real conflict concerning the application of the economic-substance doctrine that merits this Court's intervention.

d. Finally, even if the courts of appeals' different formulations of the economic-substance standard would otherwise provide a sufficient justification for this Court's review, this case would constitute a poor vehicle because it arises in a context of only limited prospective importance. In 2000, Congress foreclosed taxpayers from using contingent-liability tax shelters of the type at issue here by amending the basis rules applicable to intracorporate tax-free transfers to provide for the reduction of basis in cases such as this one. See 26 U.S.C. 358(h) (2000 & Supp. III 2003). We are aware of only three other currently pending cases concerning the application of the economic-substance doctrine to similar tax shelters. Particularly in light of the uncertainty concerning the existence (and extent) of a meaningful conflict, the limited prospective importance of this context counsels against further review.[6]

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[6] This case would additionally constitute a poor vehicle because, as the government argued below, petitioner's capital loss should be disallowed under the governing statutory provisions, regardless of the applicability of the economic-substance doctrine. Although the court of appeals ultimately rejected those arguments, it recognized that the

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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relevant statutory provisions "are not a model of statutory draftsmanship." Pet. App. 15a.